DOW THEORY LETTERS INC.

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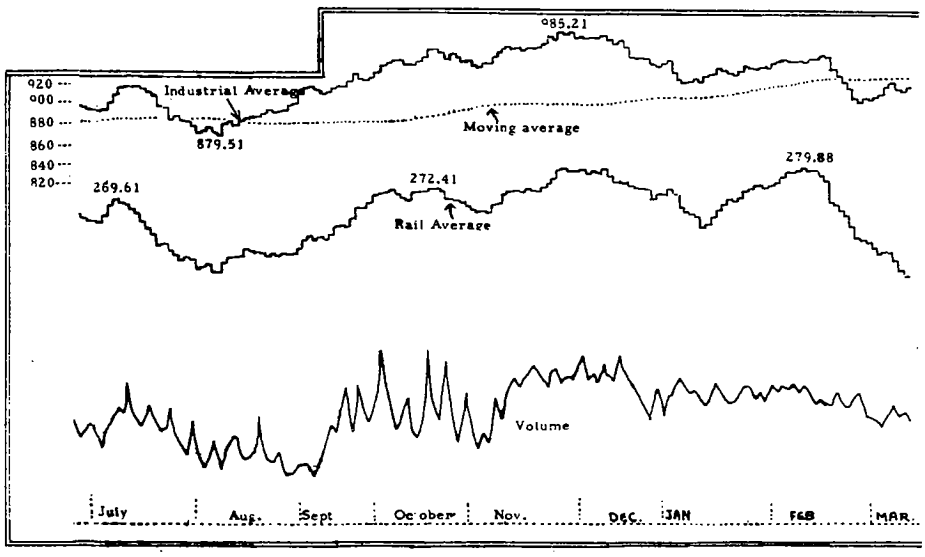
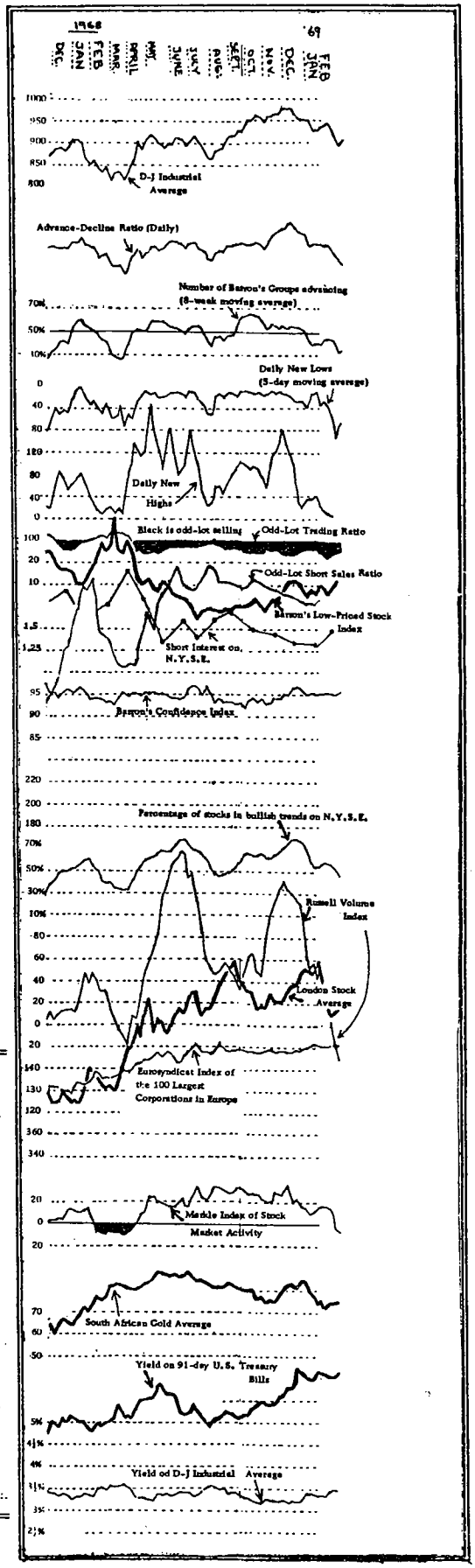
THE MARKET: One of the activities which I consider part of my job as a market soothsayer is to read prodigous quantities of literature, market literature and otherwise. After a certain number of years one sort of "absorbs" the flavor of this writing, one gets a feel as to what other people feel. Daily and weekly the reports come in, the New York Times, Drew, Schaefer, the Bond Buyer, the Economist, Life, Look, Indicator Digest, Time, Newsweek, Holt, Chartcraft, Pool, Janeway, Barron's, Granville, Standard & Poor, Christian Science Monitor, Fortune, Neill, Myers' Review, Shultz, Wall Street Journal, Forbes, the London Investor, the list goes on and on, and it's a good list.

What does it all add up to today? At present, I continue (with a few rare exceptions such as Schaefer, Granville and Janeway) to get a feeling of euphoria. "Everything is going to be all right," is what emanates from the huge pile of reports and papers, "We are not nearing a time of drastic and startling change." Of course, such thinking has been generally correct for a quarter of a century, and it's fantastically risky for any analyst to vary from it. There are probably as few men around today who are thinking in terms of huge deflation and change as there were men in 1942 thinking in terms of a quarter of a century of inflation and change.

Some people are even talking now of a planned stock market decline, as a kind of Federally-inspired inflation-brake. Leonard Scruggs of the N.Y.S.E. firm of Scruggs and Co. writes, "We can be sure that the authorities are praying for an 'optimum' break, one sufficient to dampen expectations but not severe enough to frighten the horses." McChesney Martin, Chairman of the Reserve Board, believes that the nation can undo inflation without deflating, a neat trick. He stated last week, "We can disinflate without deflation. We do mean business. The Board is unanimous. We have more to do before inflation is under control."

Last week on February 5 Mr. Nixon had his first showdown with Congress, and the showdown had to do with Mr. Nixon's request to "rearrange" the national




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Merkle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield od D-J Industrial Average

 debt by bookkeeping to make it look smaller than it is. Mr. Nixon lost, and I consider this initial major loss an ominous sign for the future. It points up the fact that Mr. Nixon's honeymoon with the Democratic Congress is over. From here on, it is going to be a question of whether Mr. Nixon can get anything done.

Meanwhile, back on Wall Street the market was bouncing lower with interspersed rallies, on volume one-third lower than that which was seen on the way up. Speculative sentiment was ruffled, but far from discouraged. The whole decline since December has felt more like a readjustment or sobering than anything resembling true liquidation. If the primary bear market is to show its teeth, those teeth have so far been hidden behind smiling lips.

Only in the Rail Average do we see any intimations of real collapse. The 1968 summer low for the Rail was recorded on August 9 at 245.76. As this is written, Rails are a fraction under their summer low.

The advance-decline ratio last week also broke its August, 1968 low, falling to its lowest level since March, 1968. A comparable break by the Dow Industrials would take that Average to the 850 range.

The Russell Volume Index broke into minus territory last week, registering minus readings for only the second time since 1966. At its current level this Index is lower than at any time since the fall of 1966. When this Index goes minus, it means that over a 60 day total period minus volume on the N.Y.S.E. has surpassed total plus volume. Such conditions signify the presence of great selling pressure. They also indicate that the market is on dangerous grounds. While a minus reading on the Russell Index does not always predict a collapse, all collapses have been accompanied by minus readings on this Index.

CONCLUSION: If this was a primary bull market, I would say that we were in generally "oversold" territory, and that within a few days to weeks the market would probably be rallying strongly. However, we are in a primary bear market, and the term "oversold" during a bear market has a vastly different meaning. During bear markets crashes can occur following an oversold condition. In other words, during a primary bear leg the market will first register selling pressure, then extreme selling pressure, then a (bull market type) oversold, and then it will crash. Remember, every crash in a bear market occurs when the normal conditions of oversold simply do not work. We will know shortly whether such is the case in this bear market.

WHERE ARE THE RESULTS? Eliot Janeway, in his recent report, has coined a new word, "econoclast." An econoclast is one who takes exception to the prevailing or standard economic forecast. Mr. Janeway, at this time, is an econoclast, and I rather think that I agree with him. Janeway believes that all the forecasts regarding an impending business slowdown are apt to be wrong, or at least wrong for a longer period of time than anyone now envisions.

There is no questioning the fact that the current backlog of business commitment is huge, and that so far the highest interest rates in history have failed to put any kind of dent in the boom. From all Administration quarters comes the word that the interest rate squeeze will be kept on until inflation is slowed. Paul McCracken, Chairman of the Council of Economic Advisers, has stated repeatedly that he expects the rate of growth to fall off throughout the rest of the year. Furthermore, Mr. McCracken states that he is willing to face an "acceptable" rise in unemployment, although he did not state how much of an actual rise he will accept.

It all sounds logical and reasonable, but a strange thing has been happening on the way to an economic slowdown. Inflation continues to persist. Living costs moved up again in January, and indications (see news clip) are that they will rise again in February. The wholesale price index jumped .8% in January, the biggest jump in three years. Thus, the rising dilemma of a monetary squeeze which is not stopping inflation is confronting a puzzled Administration.

Business roundup

Washington

Living costs rose three-tenths of 1 percent in January—and indications are for a similar increase in February, the Labor Department reports.

In addition, the wholesale-price index rose eight-tenths of 1 percent in January, the largest monthly rise in almost three years.

Chiefly responsible for the consumer-price index jump were higher costs for services, particularly auto and home repairs, and medical care.

In fact, this very thought is now coming out in the open, as witness the second Associate Press New Clip. Economists are noticing that with the highest interest rates since Lincoln's assassination, with the money supply expansion rate being slowed, with the threat of a continuation of the 10% surtax, inflation "is alive and fighting."

Last Wednesday, Federal Reserve Board Chairman McChesney Martin, expressed his own fears. He blamed the bullishness of business spending plans entirely on the expectations of continued inflation. He stated that business believes that the Fed will back down the moment tight money begins to hurt. "People say if you don't have a crunch you don't mean business. We do mean business. We are just now beginning to make headway." Thus spoke Mr. Martin.

At the same time, leading economist Pierre Rinfret announced that a continuing study of capital spending by business shows a huge increase since last fall. Business, he said, plans to spend 7% more in 1969 than 1968. Another top economist, Ralph Creasman, President of Lionel Edie, states that he is revising his estimate of capital spending for 1969 to an 11% jump over 1968. Creasman believes that as a result, the economy will be much harder to cool than the Administration believes. He feels that the Administration may have to intensify their anti-inflation stance, perhaps increase personal and corporate income taxes above the 10% surcharge level. "This is a galloping economy," he notes, "and if we don't restrain it we won't contain it."

What is the answer? Is there any way to halt the upward march of prices? My own feeling is that the answer will be more of the same, perhaps even higher interest.

It may well be that the money supply is the key to the monetary future. The Johnson Administration, while allowing high interest rates, continued to flood the nation with money in an unprecedented way. But the Nixon men are much more atune to the philosophy of Milton Friedman, who for years represented the voice in the wilderness warning about the money supply. Recently, Paul McCracken opined: "We are inclined to the position that the behavior of the supply of money is very important.....If one accepts our opinion about the great importance of the supply of money, it is probably true that a steadier rate of growth of the supply of money would have contributed to economic stability." Translation: the Nixon Administration is going to use the supply of money as an instrument to fight inflation. Interest rates are probably going to be considered secondary.

The fierce competition for money is now spreading throughout the Free World. Last week England shocked Wall Street by raising its prime rate to an astounding 8%. Sweden moved its prime rate up from 5% to 6%. Canada moved its prime rate up to 6½%. The much-sought Eurodollars which have been gobbled up by American banks are now costing Europeans 8¼% in interest.

In studying the entire situation, I am more and more inclined to the view that the problem and the fooler in the current situation is the stubborness of the inflationary pressures against the tightening of the monetary and fiscal restraints. The rise in costs is literally making a fool out of the monetary powers, and I cannot see how or why the Fed will let up on the monetary pressures while inflation continues, and herein lie the seeds of a debacle.

The Bolton-Tremblay Bank Credit Analyst is perhaps the finest service dealing with the implications of money on the economy. It was therefore with great interest that I read the latest (March) issue of this authoritative publication. Following are a few excerpts:

"Investors are operating in the most critical financial period of the past four decades. Further deterioration of the very long term money and credit trends again confirm this fact."

"Rapid changes in any major money and credit variables, even of fairly short duration, could subject the shaky structure to a shock that could not be absorbed. And the shock does not have to come directly from the banking system. As discussed in past issues, corporate liquidity is close to absolute minimums, and with shrinking resources in the non bank credit sector, a surprise bankruptcy of any size could trigger a chain reaction of debt liquidation."

"While some of the apparent restraint results from unwinding of year-end positions, enough time has passed to see that bank credit growth has been roughly zero for two months, that money supply has actually contracted over the period. The trends say that the Fed does mean business and so far, with a vengeance. If the current developments in this area are projected, for a month or so, a king-size squeeze would develop."

Conclusion: So far, the Administration fiscal and monetary policies have not halted or even put a crimp in the inflationary pressures. For this reason, it is probable that the Fed's policies will be continued or even intensified. If so, the monetary structure could come under severe pressure. Any number of crises could develop, and the stock market may be expected to reflect those potential pressures—well before they hit the financial pages of the daily newspaper.

GOLD: On March 4 the price of gold in London broke above its three-month ceiling (see chart page 4) to close at new high since the "two-tier" system was placed in operation. The next day gold shares jumped violently upwards with Dome Mines roaring above 85 to a new historic high.

Many said the rise in the gold price was in response to the latest French Government figures, which showed an $89.7 million drop in French gold and foreign currency reserves to $4.12 billion. Currently, national wage negotiations

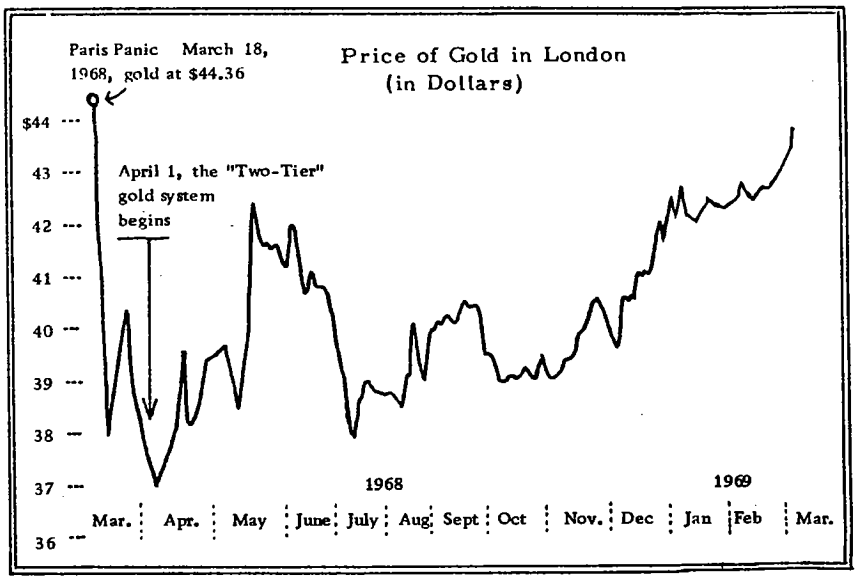
Price Of Gold Soars Again On Paris Mart

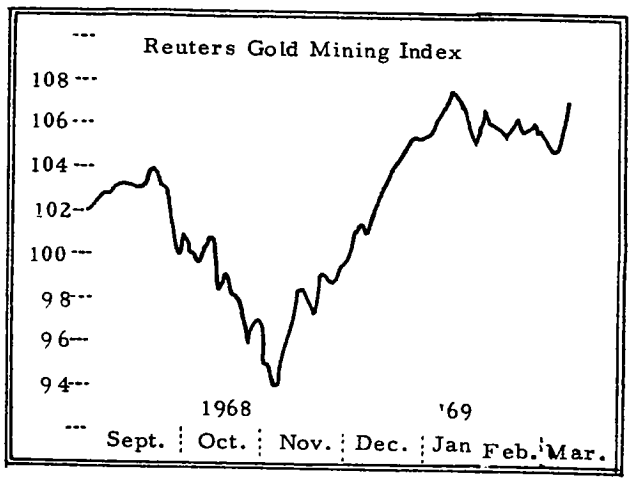
PARIS (UPI) — The price of gold on the Paris gold market skyrocketed yesterday for the second straight day as labor and business thrashed out a new wage package which could upset France's fragile economy.

Uncertainty over the government-sponsored wage renegotiations begun Tuesday and a brief nationwide strike by small shopkeepers were blamed for the new rise in the price of gold yesterday to $47 an ounce.

2ND RISE IN 2 DAYS

This represented the highest gold has climbed since the price was allowed to reflect demand last spring.





are going on in France, and many fear that a deadlock could topple the franc.

Others claim that DeGaulle has secretly presented an ultimatum to Mr. Nixon to the effect that if the price of gold is not raised within a month or so, France will come through with a whopping devaluation which will literally spread chaos across the monetary face of the Free World.

Relentlessly, the ultimate confrontation with the two-tier gold system draws closer. In their 1968 report, famed London gold dealers Mocatta and Goldsmid state that the ability of the two-tier gold system to withstand another crises "remains doubtful." For months now, the U.S. and Britain have pinned their hopes for "a lower price for gold" on the necessity of South Africa's selling gold on the free market, thereby depressing the price. But I believe it's all just wishful thinking. As my friend, Harry Schultz, stated in a recent report, "South Africa has perhaps the smallest gold reserve of any major Western trading nation. Every nation in Europe holds more monetary gold than S. Africa, which has just over $1.2 billion. France, for example, sold that much gold during her recent troubles, and it didn't hurt the price.....S. Africa could sell every ounce and it would be swallowed up by the market in a twinkling."

On Feb. 24 the Japanese press leaked the story that it wanted to buy S. African gold. The U.S. Treasury immediately stated that it doubted the story, and amid the resulting furor, the Japanese gold threat seemed to have been hushed up. But one thing is clear, the nations of the Free World want more gold, they are pushing up their gold reserves, the battle is on.

On March 6 the London price of gold hit $43, $8 above the U. S. official price. The price for gold shares soared, as informed observers speculated on when or how the whole fabric of the two-tier gold system would split apart. If only one nation comes to South Africa with a large order for gold at the open market price, if only one central bank starts arbitraging by selling gold (purchased at $35 from the U.S.) on the open market at the going price, the rush could be on.

The South African gold shares (now lagging far behind the Canadian gold shares) are starting to move up, and as seen on the chart the S. African gold index is now within a point of its high of the past few years. From the standpoint of

earnings and dividends, the S.African shares such as President Brand, Western Deep Levels, Free State Geduld, President Steyn and Blyvoors represent much greater value than do the higher-priced Canadians.

The figures suggest that S. Africa is selling small quantities of gold on the open market, that she is getting the foreign currencies which she needs. All information points to the thesis that S. Africa is willing and able to withhold her gold until the two-tier system crumbles and gold rises to a fair price in all markets.

Mr. Nixon is playing against time, and time is running out. If he does not take the gold situation in hand and meet it head on, the gold situation (as it is now doing) is going to take Mr. Nixon in hand.

SPECIAL STUDY: Whenever the Dow Industrials are not acting "as well" as Wall Street and the public would like them to, the complaint is that the Dow is an antique indicator and that it has outlived its usefulness.

I have never agreed, and I have always held that the Dow is a remarkably good barometer of the trend of high-grade investment stocks. Moreover, I have noted that when the Dow acts better than the general market, complaints seem mysteriously to fade away. It is only when the Dow is lagging the general market (or lagging the more speculative issues) that the shouts arise.

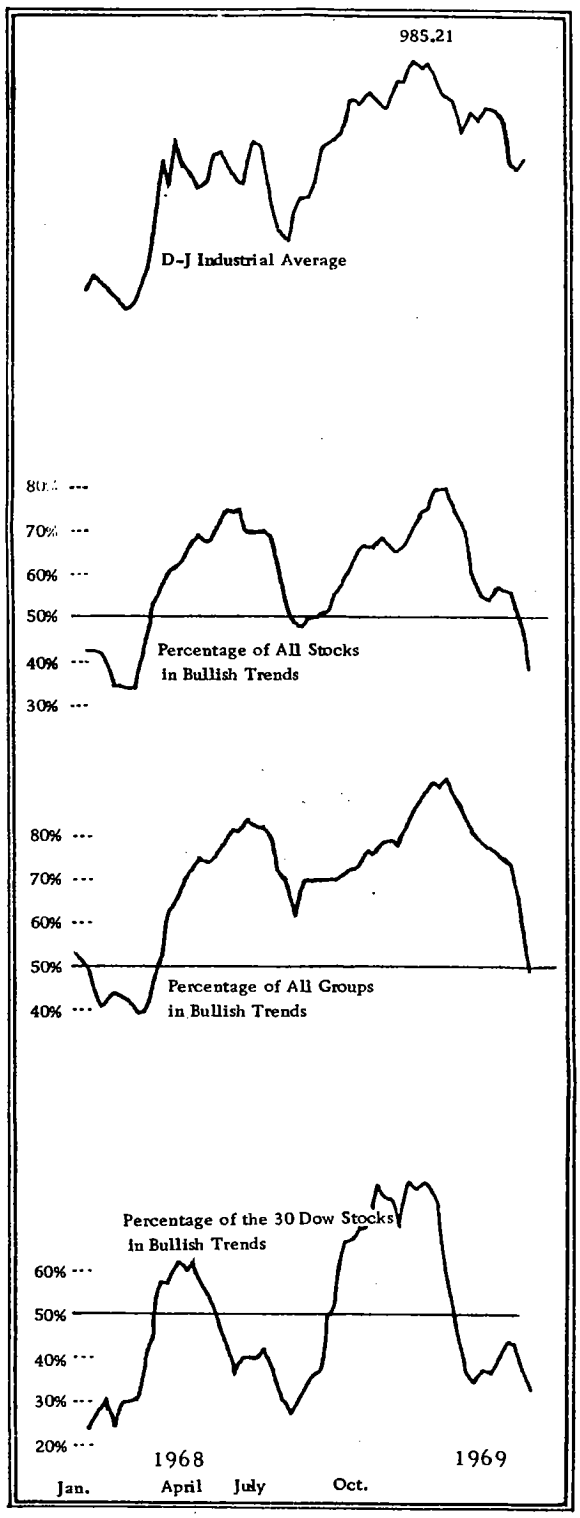
The accompanying chart is worth studying carefully. It says something about the sensitivity and leadership quality of the D-J Industrial Average. For instance, note during April, 1968, the percentage of bullish trends in the 30-Dow stocks turned down rapidly. This was followed in July by the beginning of the drop in the percentage of all stocks bullish, and in August the group bullish percentage finally turned down. The upturn showed first in the Dow, with the bullish percentage in the Dow turning up a few weeks before the bullish percentage in the groups and in all stocks.

Again, in November and December the bullish percentage in the Dow faltered, then turned down. In January, 1969, one month later, the bullish percentage in all stocks and the groups followed. Note also that in January the bullish percentage of Dow stocks dropped below the 50% level. But although the all-stock index and the group index trended lower, they held stubbornly above the 50% bullish level. Finally, last week (week ending March 7) the weakness extended throughout the market. The latest tabulations showed 47.7% of the groups bullish and 38.9% of all stock on the N.Y.S.E. in bullish trends.

Conclusion: The trend of the Dow stocks tends to lead the entire market, and any persistent trend in the Dow stocks is ultimately followed by a like trend in the majority of stocks and groups on the N.Y.S.E.

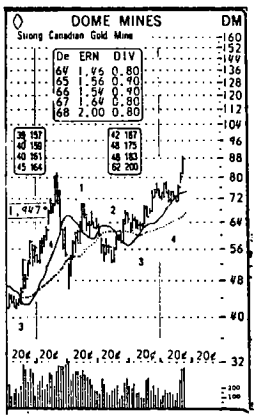
At present, the Dow is at a new low of 33% bullish or in the danger area. Historically, as long as this is the case, the market is in potential trouble.

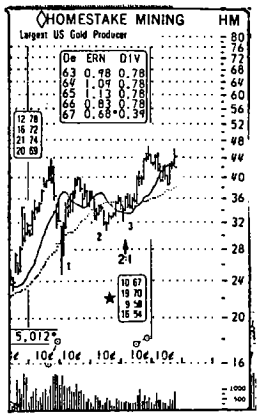
MARKET LABORATORY: Last week the market provided some rather typical bear market fireworks. The two leading charts (page 6) show Dome Mines and Homestake, two North American gold equities as theypush towards the area of their all-time highs (Dome went to an historic high). These stocks are responding to the



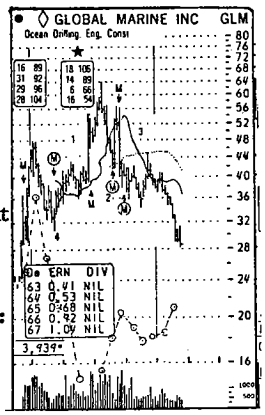
possibility of monetary chaos and the odds that the price of gold will be raised in an effort to get the Free World out of that chaos.

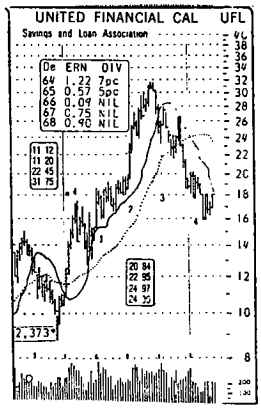
The other charts illustrate a principle which I have repeated ad that principle being that speculation during a primary bear market may be profitable—but it is a dangerous procedure. I picked all of these "collapses" at random out of the Quote Digest weekly chart book (Quote, 110 N. Lorrain, Wichita, Kansas). What I want to show is the violence and rapidity with which assorted stocks can fall apart during a bear market when the primary trend begins to assert or reassert itself. I believe that these charts underscore the lesson better than any further words which I could muster up. The lesson: stay out of a bear market, let it run its course, do not get greedy, exercise patience.

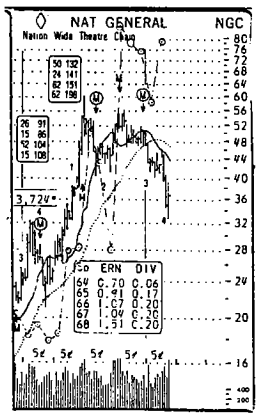




NOTES & QUOTES: One for the ages, from an interview with Admiral John S. MacCain, Jr., Commander in Chief, Pacific...."We have the enemy licked now. He is beaten. We have the initiative in all areas. The enemy cannot achieve a military victory; he cannot even mount another major offensive."

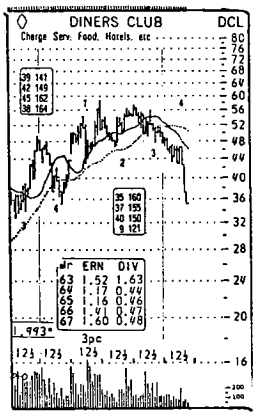


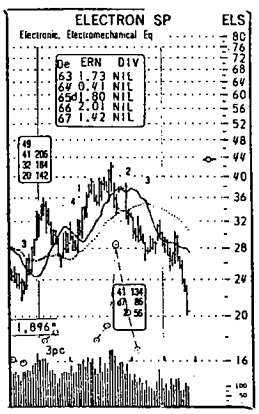


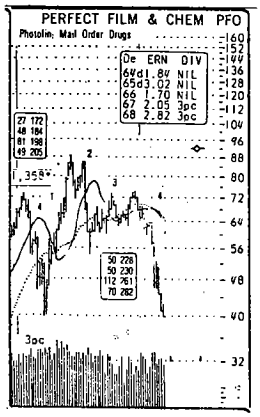


From our Opinions Which Could Be Revised Dept: (From last week's Wall Street Journal:)

> **STOCKS' SHAKEOUT** brings murmurs of delight from Washington inflation-fighters. They see the market's recent drop as needed recognition that the economy is cooling. Strength in many indicators had made it hard to get the idea across. Says one strategist: "Nothing dispels inflation psychology like a good stock-market shakeout."







Finally, a little cartoon from the L.A. Times which contains much wisdom: